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No. 90-1192

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1990

CITY OF LOCKPORT, NEW YORK, ET AL.

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioners' tax claims fall within the scope of an exception to the automatic stay provision of Section 362 of the Bankruptcy Code.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	10

TABLE OF AUTHORITIES

Cases:

Casbeer, In re, 793 F.2d 1436 (5th Cir. 1986)	6
Equibank, N.A. v. *Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80 (3d Cir. 1989)	4, 6
Huddleston v. *Dwyer*, 322 U.S. 232 (1944)	9
Maryland Nat'l Bank v. *Mayor of Baltimore*, 723 F.2d 1138 (4th Cir. 1983)	8
Midlantic Nat'l Bank v. *New Jersey Dep't of Envtl. Protection*, 474 U.S. 494 (1986)	6
Parr Meadows Racing Ass'n, In re, 880 F.2d 1540 (2d Cir. 1989), cert. denied, 110 S. Ct. 869 (1990)	5, 8, 9
Virginia Beach Fed. Sav. & Loan Ass'n v. *Wood*, 901 F.2d 849 (10th Cir. 1990)	6

Statutes and rule:

Bankruptcy Code, 11 U.S.C. 101 *et seq.*:	
Ch. 3, 11 U.S.C. 301 *et seq.*:	
11 U.S.C. 362(a)(4)	3, 6
11 U.S.C. 362(b)(3)	3, 6, 9
Ch. 5, 11 U.S.C. 501 *et seq.*:	
11 U.S.C. 546(b)	3, 4, 5, 6, 7
N.Y. Gen. City Law § 20(4) (McKinney 1989)	9
N.Y. Real Prop. Tax Law § 302 (McKinney 1984)	9
N.Y. Real Prop. Tax Law § 1312 (McKinney 1989)	7

Statutes and rule—Continued: Page

Lockport City Charter § C-172 7
Bankr. R. 7001 3

Miscellaneous:

4 L. King, *Collier on Bankruptcy* (15th ed. 1983) .. 6
H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977) 6, 7
S. Rep. No. 989, 95th Cong., 2d Sess. (1978) 6
R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* (6th ed. 1986) 9

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 916 F.2d 890. The opinion of the district court (Pet. App. 24a-37a) is reported at 111 Bankr. 107. The opinion of the bankruptcy court (Pet. App. 38a-50a) is reported at 95 Bankr. 370.

JURISDICTION

The judgment of the court of appeals was entered on October 19, 1990. The petition for certiorari was filed on January 17, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Guterl Special Steel Corporation owned real property in Lockport, New York. In 1981, Guterl gave two mortgages on the property, each in the amount of $7.5 million, to separate banks. Ninety percent of the principal and interest on each loan was guaranteed by an agency of the United States. One mortgage was guaranteed by the Economic Development Administration (EDA); the other by the Farmers Home Administration (FmHA). Pet. App. 3a.

On August 9, 1982, Guterl filed a petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of Pennsylvania. On August 26, 1983, the EDA paid 90% of the balance due on one of the outstanding notes and was assigned the bank's interest in Guterl's collateral. FmHA paid 90% of the balance due on the other note in return for an assignment of the bank's interest in the collateral.[1] Pet. App. 3a-4a.

In November 1983, the bankruptcy court ordered Guterl to liquidate the collateral securing the mortgages. In March 1984, the property was sold for approximately $9.5 million. Guterl deposited $549,550 of the sale proceeds in an escrow account pending resolution of this dispute. Pet. App. 4a.

At the time Guterl filed for bankruptcy, it had paid all real property taxes that were then due. After filing, however, Guterl failed to pay $395,427.51 in city and school taxes. Pet. App. 26a. Petitioners claim that

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[1] The record does not disclose whether the FmHA made good on its guarantee, but the court of appeals assumed, for purposes of this case, that it had done so. See Pet. App. 4a.

they are entitled to recover these unpaid taxes from the proceeds held in the escrow account.[2]

2. The bankruptcy trustee initiated a proceeding under Rule 7001 of the Bankruptcy Rules to determine entitlement to the funds placed in the escrow account. Petitioners recognized that the automatic stay triggered by the filing of a bankruptcy petition bars "any act to create, perfect, or enforce any lien against the property of the estate." 11 U.S.C. 362(a)(4). Petitioners argued, however, that their tax claims fell under 11 U.S.C. 362(b)(3), which excepts from the automatic stay acts to perfect an interest in property to the extent that the trustee's interests are subject to 11 U.S.C. 546(b). Section 546(b), in turn, provides that the trustee's power to avoid statutory liens is subject to "any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection." 11 U.S.C. 546(b).

The bankruptcy court concluded (Pet. App. 38a-50a) that the city and school tax liens were created after Guterl filed its bankruptcy petition and therefore were void under 11 U.S.C. 362(a)(4). The bankruptcy court observed that "creation [of a property interest], as opposed to perfection, is *not* excepted from the automatic stay." Pet. App. 47a. The court explained that, after bankruptcy, petitioners had done more than perfect a pre-existing interest, because "[e]ach of the relevant statutes raised by [petitioners] require[s] affirmative, primary actions to initiate lien status for real estate taxes." Pet. App. 49a. The bankruptcy court concluded that, until petitioners

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[2] The County of Niagara was a party in the court below, but has not filed a petition for certiorari. See Pet. ii.

carried out the acts of "publication, confirmation, and adoption" required by state and local law, they had no more than "an expectation of future collections." *Ibid.* Because those actions were carried out after Guterl filed its bankruptcy petition, they were "in violation of § 362(a)(4)." *Ibid.*

The district court affirmed. Pet. App. 24a-37a. It agreed with the bankruptcy court that the "earliest acts to create each of the liens were taken after the petition was filed on August 9, 1982." Pet. App. 35a.

3. The court of appeals affirmed. Pet. App. 1a-21a. Relying on its decision in *Equibank, N.A.* v. *Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80, 85 (3d Cir. 1989), the court rejected petitioners' contention that they had an "ever-present" interest in collecting property taxes. The court noted that 11 U.S.C. 546(b) applies only if "generally applicable law" permits perfection of a property interest acquired prior to the filing of the bankruptcy petition. Pet. App. 11a. The court said that, while petitioners "may have an ever-present expectation of collecting taxes on all property within their jurisdiction, they do not have a property interest in a particular piece of real estate until they take the affirmative acts necessary to fix the amount of the tax due and to acquire a lien to the extent of that amount." Pet. App. 12a.

The court of appeals then examined local law to determine the date on which petitioners' property interest was created. It concluded that the city and school taxes did not become an interest in property until notice of the city tax assessment had been published and the school tax roll was confirmed and adopted. Pet. App. 12a. Since these events occurred after the bankruptcy petition was filed, the petition-

ers' interests did not fall within the exception of 11 U.S.C. 546(b) to the automatic stay.

The court of appeals also rejected petitioners' alternative argument that the "tax status date" was the date on which petitioners' interests attached, noting that the applicable New York statutes provide that tax "liens are *created* on a certain date (not the tax status date), after certain acts are taken." Pet. App. 14a. In the court's view, the tax status date merely establishes the value of the property, and creates no more than an expectation that taxes will be collected in the future. Pet. App. 15a. The court concluded that petitioners acquire "an 'interest in property' only when [they have] performed the statutory acts necessary to give rise to a perfectible lien." Pet. App. 16a. In this case, those actions were performed after Guterl filed for bankruptcy. *Ibid.*

Judge Weis dissented in part. Pet. App. 16a-21a. In his view, the Second Circuit's decision in *In re Parr Meadows Racing Ass'n*, 880 F.2d 1540 (1989), cert. denied, 110 S. Ct. 869 (1990), held that a local government in the State of New York acquires an interest in real property on the tax status date. Judge Weis would have deferred to the Second Circuit's resolution of a question of New York law.

ARGUMENT

1. The automatic stay provision, triggered by the filing of a bankruptcy petition, prohibits "any act to create, perfect, or enforce any lien against property of an estate." 11 U.S.C. 362(a)(4). The automatic stay provision is "one of the fundamental debtor protections provided by the bankruptcy laws." *Midlantic Nat'l Bank* v. *New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 503 (1986) (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 54 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977)). Section 362(b)(3) of the Code carves out an exception to the automatic stay, by allowing "any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title." 11 U.S.C. 362(b)(3). Section 546(b), in turn, provides that the rights and powers of the trustee to avoid statutory liens "are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection." 11 U.S.C. 546(b).

Section 546(b) establishes an exception to the automatic stay where, under state law, a creditor has a prepetition interest in property that needs only to be perfected after the bankruptcy petition is filed. See *Virginia Beach Fed. Sav. & Loan Ass'n* v. *Wood*, 901 F.2d 849, 852 (10th Cir. 1990); *Equibank, N.A.* v. *Wheeling-Pittsburgh Steel Corp.*, 884 F.2d at 85; *In re Casbeer*, 793 F.2d 1436, 1442-1443 (5th Cir. 1986); 4 L. King, *Collier on Bankruptcy* ¶ 546.03[2] (15th ed. 1983). See also S. Rep. No. 989, *supra*, at 86 (Section 546(b) allows a creditor to "perfect his interest against the trustee" only if "under applicable nonbankruptcy law, and as of the date of the peti-

tion," the creditor has an existing interest which merely needs to be perfected "against an intervening interest holder."). The purpose of the Section 546(b) exception is to "protect, in spite of the surprise intervention of [the] bankruptcy petition, those whom State law protects." H.R. Rep. No. 595, *supra*, at 371. Accordingly, the validity of petitioners' contention in this case turns on the status of their tax claims under state and local law.

The bankruptcy court, district court, and court of appeals all held that, under the applicable provisions of the Lockport City Charter and the laws of the State of New York, petitioners' interests arose on the dates the city taxes were published (January 4, 1983 and January 3, 1984) and the school tax rolls were adopted (September 13, 1982 and September 1, 1983). That holding is consistent with the provision of the Lockport City Charter that city taxes "shall be a lien upon the lands on which they are assessed * * * from the first publication of the notice of such tax or assessment by the Treasurer." Lockport City Charter § C-271. See Pet. App. 63a. It also is consistent with the provision of New York law that school taxes "shall become a lien as of the date and hour of the confirmation or final adoption of the school roll." N.Y. Real Prop. Tax Law § 1312 (McKinney 1989).

The courts below reasonably construed these provisions of state and local law to conclude that petitioners did not have an interest in the property until the tax liens were created. Because the liens were created after Guterl filed its petition for bankruptcy on August 9, 1982, petitioners' interests are outside the scope of the Section 546(b) exception to the automatic stay.[3]

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[3] The logic of the court's decision is illustrated by petitioners' claim for "water rents," which are taxes on "consumed"

2. Petitioners contend that the decision in this case conflicts with the Fourth Circuit's decision in *Maryland Nat'l Bank* v. *Mayor of Baltimore*, 723 F.2d 1138 (1983), and the Second Circuit's decision in *In re Parr Meadows Racing Ass'n, Inc.*, 880 F.2d 1540 (1989), cert. denied, 110 S. Ct. 869 (1990).

In the *Maryland National Bank* case, the Fourth Circuit concluded that the City of Baltimore had an "ever-present" interest in the property at issue "by force of the generally applicable laws of Maryland" that prohibit both buyers and sellers from avoiding property taxes through sale of the property. 723 F.2d at 1142. The state and local laws at issue here, unlike the Maryland statutes construed in *Maryland National Bank*, identify "affirmative acts" necessary to acquire an interest in the property. See Pet. App. 12a. Because each decision turns on different provisions of state and local tax law, they are not in conflict.

In *Parr Meadows*, the Second Circuit considered and rejected both the secured creditors' assertion that Suffolk County has no property interest until taxes became due and payable, and the County's assertion that it has an ever-present interest in the property. The court's narrow conclusion was that "*for the tax system in Suffolk County*, neither rationale is correct." 880 F.2d at 1546 (emphasis added). The Second Circuit construed the Suffolk County Tax Act to provide that the County acquired a property interest on the "tax status date" of each

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water added to the city property tax bill. See Pet. App. 61a. Because Guterl had paid its taxes in full prior to filing the petition for bankruptcy, petitioners are asserting that they had a property interest in unpaid water rents before the water was consumed.

year.[4] *Id.* at 1547. Here, the court of appeals construed the Lockport City Charter rather than the Suffolk County Tax Act.

Even if the decision in this case were in some tension with *Maryland Nat'l Bank* or *Parr Meadows*, certiorari would not be warranted. In each case, the decision turned on the nature of a property interest created by state or local tax law rather than any provision of the Bankruptcy Code. This Court generally does not review a federal court of appeals' determination of a question of state law. *Huddleston* v. *Dwyer*, 322 U.S. 232, 237 (1944); see R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* § 4.10, at 211 (6th ed. 1986). Any uncertainty about the interpretation of the laws of New York or the City of Lockport can be resolved authoritatively by the state courts, or by state or local legislation. Because the court of appeals has decided a non-federal question of limited significance, it warrants no further review.[5]

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[4] Although the Second Circuit cited N.Y. Real Prop. Tax Law § 302 (McKinney 1984), that statute applies to cities, towns, and school districts, but *not* to counties. See Pet. App. 14a n.4. See also N.Y. Gen. City Law § 20(4) (McKinney 1989) (delegating to local governments the taxation of real property). Thus, the Second Circuit was obliged to look to the Suffolk County Tax Act to determine when Suffolk County acquired an interest in real property.

[5] Although petitioners assert (Pet. 9-12) that 11 U.S.C. 362(b)(3) excepts their tax claims from the automatic stay, they concede (Pet. 9) that the exception of Section 362(b)(3) applies only if, under applicable state and local laws, they acquired an interest in the property before the bankruptcy petition was filed. The courts below, construing Lockport's Charter and the laws of New York, reasonably concluded

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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that petitioners did not acquire a property interest until after the petition was filed.

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